Il Sole 24 ORE

Transatlantic Comparisons: A Spur to Action

By Alessandro Leipold
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Here we are: three electoral debates later and we still do not know how the two candidates for the White House intend to address the main source of uncertainty weighing on current U.S. economic growth prospects: the looming "fiscal cliff." Both candidates, mired as they are in the indecisiveness of the entire U.S. political system, have studiously shunned the issue, avoiding to even utter the words. While pundits get highly exercised about who won each of the debates, there is in fact one clear winner in the electoral campaign to date, and it is a prevailing sense of uncertainty.

In the absence of a Congressional agreement by year-end to raise the public debt ceiling, massive across-the-board spending cuts and hefty tax increases will be automatically triggered. Such a scenario would be so detrimental to growth that the IMF, in its latest economic forecasts, steered clear of contemplating it in its baseline. The IMF did however warn, in no uncertain terms, that the U.S. fiscal cliff is – along with the European debt crisis – a major downside risk for the global economy. And Moody's has also given notice that it stands ready to downgrade the United States' triple-A rating in the absence of an agreement which would avoid this abyss. Those who find consolation in the fact that the Standard and Poor's downgrade of August 2011 was without dramatic consequences, overlook the fact that multiple downgrades have non-linear effects, as they trigger investment limits for various institutional investors.

Since the start of the euro crisis, there has been much lamentation over the shortcomings of Europe's response. And with good reason. Although it may be of scant consolation, it should nonetheless be noted, first, that the U.S. fiscal problem is, at least at the aggregate level, more acute than that of the euro area, and, second, that the policy response has been at least equally deficient across the Atlantic. The U.S. budget deficit is projected at 7.3% of GDP in 2013 – nearly three times that of the euro area, and four times that forecast for Italy (latest IMF estimates). The gap is even more pronounced in structural (cyclically adjusted) terms: against a structural deficit of 5.5% of GDP in the

U.S., the euro area is set to approach balance and Italy to record a structural surplus (of 0.6% of GDP). Furthermore, while little has been done in the U.S. to contain the costs of aging, the IMF notes that, thanks to recent reforms, "Italy is now in the best situation, across all advanced economies, in facing the pressure from increasing spending on health care and pensions over the next 20 years."

These elements alone do not of course capture a far more complex reality, wherein the U.S. economy displays many strengths and a greater dynamism than that of Europe. But the fact remains that the unresolved problem of a U.S. public debt projected to rise incessantly over the next five years – albeit from lower levels than those in Europe – weighs heavily on the global growth outlook. In this setting, the ineptitude of the policy response is even more disquieting. Not only has the U.S. political system been unable to draw up a balanced, medium-term debt reduction program, but it has actually made matters worse, with one misstep after the other. First, the administration let the sensible proposals of the bipartisan Simpson-Bowles commission drop by the wayside; second, Republican lawmakers exercised a sterile opposition to raising the debt ceiling; and finally both parties converged on the "brilliant" idea of trying to force a solution by the end of the year via the threat of fiscal Armageddon. The end of the year is not far off, the self-inflicted Armageddon is around the corner, but a solution is nowhere to be seen – indeed, not even any attempts to work one out.

By comparison, despite all of its inherent shortcomings, Europe's response – both in terms of adjustment and overall institutional approach – seems both enlightened and far-sighted. This is not a comparison that should in any way leave one self-satisfied, and much remains to be done in the euro area even after the recent much-awaited launch of the ESM. Reasons for concern abound. But there are times when a relatively gratifying comparison can serve as an encouragement and a spur to action. It is in this sense that it should be taken: to continue resolutely on the road of European integration, in the spirit of the Nobel Peace Prize to the EU, and to advance the reform process in Italy.